

Message Text

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C O N F I D E N T I A L SECTION 01 OF 03 BONN 04032

E.O. 11652: GDS

TAGS: PFOR, EAIR, WB, WG, FR, UK, US

SUBJECT: PROPOSED POLITICAL LEVEL APPROACH TO THE FRG

ON IGS MATTERS

REF: A) BONN 3245; B) STATE 10836

1. SUMMARY: UK EMB HAS PROPOSED A JOINT POLITICAL LEVEL APPROACH TO THE FRG OUTLINING PROPOSED ALLIED MEASURES ON THE IGS TO BE MADE BEFORE THE FARE INCREASE APPLICATION AND ROUTE SWAP PROPOSAL ARE PRESENTED IN THE BCATAG. WE EXPRESSED DOUBTS AS TO THE ADVISABILITY AND UTILITY OF THE APPROACH BUT AGREED ON AD REF BASIS TO NON-PAPER WHICH WOULD BE LEFT WITH GERMANS IF REPEAT IF THE DEPT AGREES WITH BRITISH PROPOSAL TO MAKE THE INITIATIVE. A PART OF THE TEXT WHICH WE COULD NOT AGREE HAS BEEN LEFT IN BRACKETS. SINCE THE APPROACH AS NOW PROPOSED BY UK WOULD COMMIT US TO PURSUING A FARE INCREASE WE BELIEVE, AT A MINIMUM, IT SHOULD BE POSTPONED UNTIL PAA'S REVISED DATA ON THE EFFECTS OF THE ROUTE SWAP IS EVALUATED.
ACTION REQUESTED: DEPT'S VIEWS. END SUMMARY.

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2. SHORTLY AFTER EMB. ASST. CAA BRIEFED THE BRITISH AND

FRENCH CAA'S RE THE DEPT'S VIEWS ON THE SWAP AGREEMENT, UK MINISTER HIBBARD CALLED ON DCM TO SUGGEST THAT A POLITICAL LEVEL APPROACH BE MADE TO THE FRG PRIOR TO BCATAG CONSIDERATION OF THE FARE INCREASE AND RATIONALIZATION PROPOSALS. HIBBARD ARGUED THAT THE CONSIDERABLE PUBLICITY GIVEN BERLIN AIR MATTERS IN THE LAST SEVERAL MONTHS REQUIRED THAT THE ALLIES MAKE CLEAR THEIR INTENTIONS TO THE GERMANS IN ORDER TO PAVE THE WAY FOR AN EXAMINATION AT THE FRG WORKING LEVEL WHICH WOULD COME UP WITH THE CORRECT ANSWERS FROM THE ALLIED POINT OF VIEW. AS A NON-PAPER TO LEAVE WITH THE GERMANS THE BRITISH WORKED FROM THE DRAFT ON SUBSIDIES PREPARED IN WASHINGTON DURING THE DECEMBER CONSULTATIONS. THE REVISED BRITISH TEXT LISTED THE ALTERNATIVE SOLUTIONS TO IGS ECONOMIC PROBLEMS CONSIDERED BY THE ALLIES (INCLUDING A SUBSIDY INCREASE) AND POINTED OUT THAT THE ALLIES HAD DECIDED TO LIMIT THEIR APPROACH TO A FARE INCREASE AND THE ROUTE DIVISION.

3. WE INITIALLY TOOK THE POSITION THAT A POLITICAL APPROACH APPEARED UNNECESSARY AT THIS POINT SINCE THE FOREIGN OFFICE WAS ALREADY FULLY PRIMED FOR BCATAG DISCUSSIONS OF BOTH THE FARE AND ROUTE SWAP PROPOSALS. MOREOVER, AS A MATTER OF TACTICS WE SAW LITTLE TO BE GAINED BY ESCALATING THESE ISSUES BEFORE WE HAD HAD THE OPPORTUNITY FOR PRESENTATION AND DISCUSSION IN THE BCATAG. NONETHELESS, GIVEN THE IMPORTANCE THE BRITISH ATTACHED TO THE PROPOSAL WE UNDERTOOK TO ATTEMPT TO WORK OUT AN ACCEPTABLE NON-PAPER DRAFT ON AN AD REF BASIS FOR SUBMISSION TO CAPITALS. REGARDING THE LEVEL OF ANY POLITICAL APPROACH, THE UK REPS HAVE RETREATED FROM EARLIER PROPOSAL THAT IT BE MADE AT VAN WELL LEVEL AND ARE NOW TALKING IN TERMS OF OFFICE DIRECTOR LEVEL; WE HAVE TOLD THEM THAT BONN GROUP DELIVERY WOULD BE MORE APPROPRIATE.

4. IN GENERAL, WE FOUND THE BRITISH DRAFT A SUPERFICIAL REPETITION OF OFT STATED CLICHES RE THE IMPORTANCE OF THE IGS TO BERLIN VIABILITY AND THE ECONOMIC PROBLEMS FACING THE AIRLINES. MORE IMPORTANTLY, THE TEXT CONTAINED A

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NUMBER OF ASSERTIONS RE CARRIER OPERATING RESULTS WHICH WERE DESCRIPTIVE OF BA'S POSITION BUT HARDLY DEFENSIBLE IF PAA'S PERFORMANCE WAS CONSIDERED IN ISOLATION. (PAA OFFICIAL CARLSEN'S PRELIMINARY ESTIMATES REPORTED IN REFTEL A REINFORCED OUR CONCERN ON THIS POINT.) WE ALSO OPPOSED INSERTING THE LEVEL OF FARE INCREASE THE AIRLINES WERE SEEKING UNTIL FINAL FINANCIAL DATA FROM BOTH CARRIERS HAD BEEN RECEIVED AND EVALUATED. DURING

SEVERAL DRAFTING SESSIONS WE REITERATED OUR DOUBTS RE THE UTILITY OF THE EXERCISE AND HAVE RESERVED ON DESIRABILITY, BUT AGREED TO A TEXT ON AD REF BASIS FOR SUBMISSION TO CAPITALS FOR USE IF THE DEPT. AGREES TO BRITISH PROPOSAL. BEGIN TEXT:

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C O N F I D E N T I A L SECTION 02 OF 03 BONN 04032

INTERNAL GERMAN AIR SERVICES (IGS)

1. AS THE FEDERAL GOVERNMENT/SENAT IS AWARE THE ECONOMIC SITUATION OF THE THREE ALLIED AIRLINES (PAN AMERICAN, BRITISH AIRWAYS AND AIR FRANCE) ON THEIR BERLIN SERVICES HAS BEEN DETERIORATING FOR SOME TIME. OVER THE PAST YEAR, THIS DETERIORATION HAS ACCELERATED. THIS HAS RECENTLY LED PANAM AND BA TO DISCUSS THE POSSIBILITY OF MORE EXTENSIVE MEASURES OF RATIONALIZATION TO TRY TO STEM THEIR LOSSES ON THE IGS. NEWS OF THEIR DISCUSSIONS HAS LEAKED TO THE PRESS IN BERLIN AND HAS ATTRACTED MUCH ATTENTION IN RECENT WEEKS. THE ALLIED GOVERNMENTS THINK IT DESIRABLE TO EXPLAIN TO THE FEDERAL GOVERNMENT/SENAT HOW ALLIED AUTHORITIES NOW VIEW THE SITUATION.

2. FOR SEVERAL YEARS THE ALLIED AIRLINES HAVE HAD TO ASK FOR PERIODIC INCREASES IN FARES. THESE HAVE BEEN IMPLEMENTED AFTER DISCUSSIONS SOMETIMES LASTING SEVERAL MONTHS. THE RESULTING ECONOMIC UNCERTAINTY HAS NOT BEEN SATISFACTORY EITHER TO THE AIRLINES OR TO THE FEDERAL REPUBLIC OF GERMANY OR TO THE TRAVELLING PUBLIC. IT IS ASSUMED THAT THE FEDERAL GOVERNMENT ATTACHES HIGH

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POLITICAL IMPORTANCE TO THE MAINTENANCE OF AIR SERVICES BY THE THREE ALLIED AIRLINES AS PART OF THE CONTINUING PROCESS OF ASSERTING SYMBOLICALLY AND IN PRACTICE THE ALLIED COMMITMENT TO MAINTAINING ACCESS RIGHTS TO BERLIN WHICH ARE ESSENTIAL TO THE VIABILITY OF THE CITY.

3. THE ROOT CAUSE OF THE AIRLINES' DIFFICULTIES IS THE PROTRACTED AND STILL CONTINUING SHRINKAGE OF THE BERLIN AIR TRAVEL MARKET SINCE THE COMING INTO FORCE OF THE QUADRIPARTITE AGREEMENT AND THE TRANSIT TRAFFIC AGREEMENT ON 3 JUNE, 1972. PASSENGER TRAFFIC ON THE IGS HAS FALLEN BY 37 PERCENT SINCE THEN. THERE IS NO PROSPECT THAT THE TRAFFIC FIGURES WILL RECOVER. IN FACT, THE MOST RECENT MARKET TRENDS APPEAR TO DEMONSTRATE THAT THE DECLINE IN THE NUMBER OF PASSENGERS IS ACCELERATING.

4. BRITISH AIRWAYS AND PAN AMERICAN AIRWAYS SUCCEEDED DURING 1974 IN CARRYING OUT VARIOUS MEASURES OF RATIONALIZATION IN COOPERATION. THEY BROUGHT THE TOTAL CARRYING CAPACITY OFFERED NEARER TO EXISTING DEMAND BY ELIMINATING SOME UNECONOMIC SERVICES. HOWEVER, IN FULFILLMENT OF THE ALLIES' RESPONSIBILITIES TO THE PEOPLE OF BERLIN, THEY HAVE CONTINUED, TOGETHER WITH AIR FRANCE, TO PROVIDE FOR THE CITY A RANGE AND FREQUENCY OF SERVICES WHICH FAR SURPASSES WHAT IS AVAILABLE ON INTERNAL FLIGHTS TO OTHER GERMAN CITIES. ALTHOUGH THE RESULT OF THE RATIONALIZATION METHODS AGREED SO FAR HAS BEEN HELPFUL THE AVERAGE LOAD FACTOR ON THE IGS HAS REMAINED LOW. THE HIGHEST RECENT AVERAGES WERE (BLANK) PERCENT FOR BRITISH AIRWAYS AND (BLANK) PERCENT FOR PAN AMERICAN IN THE SUMMER OF 1972: PRESENT AVERAGES ARE (BLANK) PERCENT AND (BLANK) PERCENT RESPECTIVELY.

5. THE SITUATION IS MADE MORE DIFFICULT BY THE FACT THAT THE FARES FOR AIR JOURNEYS TO AND FROM BERLIN HAVE TRADITIONALLY BEEN KEPT LOW IN CONSIDERATION OF THE CITY'S ISOLATION AND OF THE FACT THAT THE AIR ROUTES THROUGH THE AIR CORRIDORS PROVIDE THE ONLY COMPLETELY RELIABLE MEANS OF TRANSPORTATION TO AND FROM THE FEDERAL REPUBLIC. THE EFFECTS ON THE AIRLINES' REVENUES OF THE LOW LEVEL OF FARES HAVE IN THE PAST BEEN PARTLY OFFSET BY THE FEDERAL GERMAN SUBSIDY PAYMENTS. BUT THE TOTAL AMOUNT OF SUBSIDY PAYMENTS TO THE AIRLINES HAS FALLEN IN PROPORTION TO THE FALL-OFF IN TRAFFIC.

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WHEREAS IN 1971 THE AIRLINES RECEIVED DM
(BLANK) IN SUBSIDIES, IN 1974 THEY RECEIVED ONLY DM
(BLANK). THE ECONOMIC DIFFICULTIES HAVE
MOREOVER BEEN MADE WORSE IN THE PAST YEAR AND ONE-HALF
BY THE EXTENSIVE INCREASE OF FUEL PRICES AND OTHER
INFLATIONARY FACTORS. A FUEL SURCHARGE FOR IGS OF 10
PERCENT WAS IMPLEMENTED IN JUNE 1974. THE FUEL SUR-
CHARGES ALLOWED TO LUFTHANSA DURING 1974 HAVE AMOUNTED
TO 14 PERCENT AND IN EUROPE GENERALLY TO 23 PERCENT IN
THAT YEAR. ONE OF THE RESULTS OF THESE FACTORS IS THAT
AT THE PRESENT TIME, THE RETURN TO THE AIRLINES PER
PASSENGER MILE IS FAR BELOW THE AVERAGE RETURN PER
PASSENGER MILE OF LUFTHANSA'S COMPARABLE INTERNAL ROUTES
IN THE FEDERAL REPUBLIC.

6. AGAINST THIS BACKGROUND OF CONTINUING DETERI-
ORATION OF THE ECONOMIC SITUATION ON THE IGS, THE ALLIED
AUTHORITIES HAVE BEEN CONSIDERING AGAIN WHAT MEASURES
MIGHT BE TAKEN TO RESTORE THE POSITION OF THE IGS. THE
THREE BROAD POSSIBILITIES ARE AN INCREASE IN FARES, AN
INCREASE IN THE SUBSIDY PAID BY THE FEDERAL GERMAN
GOVERNMENT, AND FURTHER MEASURES OF RATIONALIZATION. IN
RECENT WEEKS BRITISH AIRWAYS AND PAN AMERICAN AIRWAYS
HAVE MADE CONSIDERABLE PROGRESS IN DISCUSSING FURTHER

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RATIONALIZATION BETWEEN THEMSELVES. THEIR PROPOSALS HAVE NOT REACHED THE STAGE WHERE THEY ARE READY FOR DISCUSSION BETWEEN THE ALLIED GOVERNMENTS AND THE FEDERAL GERMAN GOVERNMENT, BEGIN U.S. BRACKETS: BUT IT IS ALREADY APPARENT FROM PRELIMINARY REVENUE AND COST CALCULATIONS THAT EVEN SUCH MEASURES AS THE DIVISION OF ROUTES BETWEEN THE AIRLINES WOULD NOT ENTIRELY SOLVE THE ECONOMIC PROBLEMS OF THE IGS END U.S. BRACKETS: AS NOW EXACERBATED BY ENORMOUS INCREASES IN COSTS AND THE CONTINUING DECLINE IN TRAFFIC. THE ALLIED AUTHORITIES THEREFORE INTEND TO TABLE IN THE NEAR FUTURE IN THE BERLIN CIVIL AIR TRANSPORT ADVISORY GROUP A PROPOSAL FOR A (BLANK) PERCENT FARES INCREASE FOR THE IGS. THE FINANCIAL DATA SUPPORTING THIS APPLICATION, WHICH WILL TAKE INTO ACCOUNT AS FAR AS POSSIBLE AT THIS STAGE THE EFFECTS UPON AIRLINE COSTS OF THE FURTHER RATIONALIZATION MEASURES UNDER CONSIDERATION, BEGIN U.S. BRACKETS: WILL DEMONSTRATE THAT EVEN THESE MEASURES WOULD NOT FULLY RESOLVE THE PROBLEMS FACING THE IGS END U.S. BRACKETS. IN THE CIRCUMSTANCES THE ALLIED AUTHORITIES

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HOPE THAT IT WILL BE POSSIBLE FOR THE FARE INCREASE TO BE DEALT WITH RAPIDLY IN THE BCATAG. A FULLER DISCUSSION OF PROPOSED RATIONALIZATION MEASURES WOULD FOLLOW AS SOON AS PLANS FOR THEM HAVE BEEN FINALIZED BETWEEN PAN AMERICAN AIRWAYS AND BRITISH AIRWAYS, AND CONSIDERED BY THE ALLIED GOVERNMENTS.

7. THE ALLIED AUTHORITIES WOULD POINT OUT THAT, EVEN WITH THE PROPOSED INCREASE IN FARES AND THE INTRODUCTION OF A FURTHER EXTENSIVE DEGREE OF RATIONALIZATION SUCH AS THAT NOW BEING PLANNED BETWEEN PAN AMERICAN AIRWAYS AND BRITISH AIRWAYS THE AIRLINES WILL STILL BE PROVIDING AN EXCELLENT SERVICE AT A FARE LEVEL WELL BELOW COMPARABLE INTER-CITY FARES ON FRG DOMESTIC SERVICES.

8. IT WILL BE SEEN THAT OF THE THREE BROAD POSSIBILITIES FOR RESTORING THE ECONOMIC POSITION OF THE IGS, THE ALLIED AUTHORITIES ARE PURSUING TWO AT THE PRESENT TIME, VIZ, A FARES INCREASE AND FURTHER RATIONAL-

IZATION, BUT NOT AN INCREASE IN THE SUBSIDY. IT IS OF GREAT IMPORTANCE THAT THERE SHOULD BE SWIFT ACTION ON THE TWO WHICH ARE BEING PURSUED. END TEXT.

5. COMMENT: AT A MINIMUM, WE WOULD RECOMMEND POSTPONEMENT OF ANY APPROACH TO THE FRG ON IGS MATTERS UNTIL WE HAVE COMPLETED OUR RE-EVALUATION OF THE FARE INCREASE EXERCISE IN THE LIGHT OF DATA REFLECTING THE EXPECTED FINANCIAL IMPACT OF THE SWAP AGREEMENT. REGARDING THE TEXT GIVEN PARA 4 ABOVE, WE HAVE POINTED OUT TO UK REPS HERE THAT PARA 6 BEGINNING WITH FOURTH SENTENCE IS QUESTIONABLE FROM US POINT OF VIEW SINCE PAN AM'S EXPERIENCE ON IGS WOULD NOT SUPPORT POINT. STATEMENT IS ACCURATE FROM OVERALL IGS VIEWPOINT, AND CERTAINLY FOR BA, HOWEVER. POINT MADE IN THIS SECTION OF PARA 6 IS, OF COURSE, THE HEART OF THE UK ARGUMENT AND ITS DELETION WOULD FURTHER GUT PAPER TO MEANINGLESSNESS. WE HAVE TOLD UK REPS THAT WORDSMITHING REQUIRED HERE HAS RECONFIRMED OUR DOUBTS ABOUT USEFULNESS OF ENTIRE EXERCISE THE JUSTIFICATION FOR WHICH HAVING SEEMED TO DISAPPEAR SINCE DECEMBER BY VIRTUE OF THE AGREEMENT BETWEEN THE AIRLINES ON A ROUTE SWAP. ACTION REQUESTED: DEPT'S VIEWS ON THE UK PROPOSAL, INCLUDING LEVEL, AND COMMENTS ON THE DRAFT NON-PAPER.

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